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UMBRELLA ENTITY FRAMEWORK: REIMAGINING THE ROLE OF PRIVATE PARTICIPANTS IN PAYMENT SYSTEMS

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Introduction

Over the recent years, cashless payments have become one of the preferred modes of retail transaction in India – particularly in urban markets. For instance, UPI, a real time fund transfer interface, has significantly scaled-up since its launch, growing from 0.09 million transactions worth 30.9 million in the month of August 2016 (when it launched) to clocking 56 billion transactions worth INR 2.85 trillion in the month of August 2020. While the impetus on cashless payments was fuelled in part by focussed government campaigns, the current challenges stemming from the Covid-19 pandemic have perhaps made cashless modes of payment the most dependable option for consumers and retailers across most cities in India – the implication being that the cashless payment industry is poised to double to \$135.2 billion by 2023.

The UPI system is operated by the National Payments Corporation of India (NPCI) – an umbrella organisation set up by the Reserve Bank of India (RBI) and the Indian Banks' Association, under the provisions of the Payment and Settlement Systems Act, 2007 (PSS Act). However, the concerns regarding the systemic risk arising from concentrating operations of a significant portion of retail payments in one entity had been on the radar of the RBI for quite some time now, and coupled with the pressure to open up the sector for competition from private players, the RBI has now put in place a regulatory framework that allows private players to establish and operate retail payments systems that enables fund-transfer and merchant payment systems.

Further to the policy publication titled "Policy Paper on Authorisation of New Retail Payment Systems" issued by the RBI in January 2019 (accessible [here](#)), the RBI had released a draft regulatory framework for authorisation and operation of new pan-India umbrella entities for retail payments in India (Umbrella Entities), and had invited public comments on the draft framework (accessible [here](#)). After due deliberations on the public comments / feedback received, the RBI has published the final form of the Framework for Authorisation of Pan-India Umbrella Entity for Retail Payments (Final Framework) on 18 August 2020 (accessible [here](#)).

While the Final Framework effectively allows private players to set up independent fund-transfer and merchant payment systems in India (effectively paving the way for a robust and competitive payments system market in India), the scope of the payment systems activities that can be carried out by an Umbrella Entity under the aegis of the Final Framework is quite broad and leaves room for private players to develop innovative use-case scenarios.

An overview of the key retail payments related services that an Umbrella Entity is permitted to provide in terms of the Final Framework is as follows:

- set-up, manage, and operate new payment system(s) in the retail space comprising of, but not limited to ATMs, White Label PoS, Aadhaar based payments and remittance services, etc;
- operate clearance and settlement systems for participating banks and non-banks;
- identify and manage settlement, credit, liquidity and operational risks, and preserve the integrity of the system(s); and
- monitor retail payment system developments and related issues in the country and internationally, to avoid shocks, frauds, and contagions that may adversely affect the system(s) and/or the economy in general, and frame necessary rules and related processes to ensure that the system is safe and sound.

In this ergo, we have highlighted the key differences between the draft framework and the Final Framework. We have also briefly summarised the RBI authorisation requirements for an Umbrella Entity.

Key changes from the draft framework placed for public comments

The Final Framework is based largely on the same lines as the draft framework document that was placed for public comments by RBI, barring the following key changes:

- **Interoperability:** The payment system is expected to be interoperable, to the extent possible, with the systems operated by the NPCI.
- **Timeline for commencement of business:** An Umbrella Entity is required to commence business / operations within a time period of 6 months, extendable to a maximum period of one year, from the date of 'in-principle approval'.
- **Lock-in:** While the draft framework provided for a mandatory dilution of promoter stake to 25% after 5 years of the commencement of business of the Umbrella Entity, the Final Framework has made this dilution requirement discretionary and stipulates that the promoter / promoter group shareholding "*can be diluted to a minimum of 25% after 5 years of the commencement of business*" of the Umbrella Entity – nevertheless, implying that there is a promoter lock-in of 25% of total shareholding at all times. It is also unclear whether this provision implies that there is a carte-blanche restriction on any dilution of the stake held by the promoters during the first five years of operations of the Umbrella Entity. The Final Framework states that the promoters / promoter groups are only required to demonstrate an upfront capital contribution of not less than 10% of the total paid-up capital (pegged at a minimum of INR 5 billion), and balance capital is required to be secured at the time of commencement of business / operations of the Umbrella Entity.
- **Innovation and financial inclusion:** The Final Framework stipulates that the Umbrella Entity shall offer "*innovative payment systems to include hitherto excluded cross-sections of the society and which enhance access, customer convenience and safety and the same shall be distinct yet interoperable*". It is unclear whether this is a gating condition for the grant of a license under the

Final Framework, or whether this is an aspirational criterion that all applicants will have to work towards after receipt of the license for setting up an Umbrella Entity.

Recap - authorisation requirements

The key conditionalities / criteria for grant of an authorisation for setting up an Umbrella Entity was previously covered in an Ergo published by us on the draft framework (accessible [here](#)). Please see below a brief summary of the conditionalities / criteria identified in the Final Framework document published by RBI.

- **Form of entity:** The Umbrella Entity should be a company incorporated under the Companies Act, 2013 and needs to be authorised by the RBI under Section 4 of the PSS Act.
- **Promoter:** The promoter / promoter group of the Umbrella Entity should be "*owned and controlled by resident Indian citizens*" with at least three years of experience as a Payment System Operator (PSO), Payment Service Provider (PSP), or Technology Service Provider (TSP). The shareholding pattern is required to be diversified and any entity holding more than 25% of the paid-up capital of the Umbrella Entity shall be deemed to be a promoter, provided that no single promoter / promoter group can hold more than 40% of the share capital of the Umbrella Entity.
- **Foreign Investment:** In case of any foreign investment in the form of Foreign Direct Investment (FDI) or Foreign Portfolio Investment (FPI), the Final Framework stipulates that such investment shall: (a) fulfil the capital requirements / norms that have been prescribed under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 ("**Non-Debt FDI Rules**"); and (b) be subject to the necessary approval of the competent authority under these rules. Retail payment systems would fall under "*Other Financial Services*" category under the Non-Debt FDI Rules. While 100% foreign investment is permissible under automatic route in the "*Other Financial Services*" sector, the Non-Debt FDI Rules clarify that foreign investments in this category are subject to the conditionalities including minimum capitalization norms that are prescribed by the relevant regulatory authority. Accordingly, any foreign investment in an Umbrella Entity would be subject to the shareholding and minimum capital related norms and restrictions that are contemplated in the Final Framework - the key implication being that any single foreign investor cannot hold in excess of 25% of the total share capital of the Umbrella Entity.
- **Fit and Proper criteria:** The promoter / promoter group must fulfil the "*fit and proper*" criteria prescribed by the RBI. The Final Framework clarifies that if any question arises as to whether a person is a "*fit and proper*" person, the RBI's decision on such question shall be final.
- **Capital Requirements:**
 - The Umbrella Entity shall have a minimum paid-up capital of INR 5 billion.
 - Promoters to upfront demonstrate capital contribution of at least 10% (*ie*, INR 500 million) at the time of making an application with the RBI and the balance capital needs to be secured at the time of commencement of business / operation of the Umbrella Entity.

- Promoter / promoter group has the discretion to dilute its / their shareholding to not less than 25% after 5 years of the commencement of business by Umbrella Entity.
 - A minimum net-worth of INR 3 billion must be maintained at all times.
- **Governance Structure:** The Umbrella Entity will have to adopt the corporate governance norms issued by the RBI for persons to be appointed on the board of the Umbrella Entity. Additionally, the RBI reserves the right to approve the appointment of directors and to nominate a member on the board of the Umbrella Entity.

Conclusion

India's UPI infrastructure is being heralded as the gold standard for seamless digital payment systems. In a paper titled "*The design of digital financial infrastructure: lessons from India*", the Bank for International Settlements has observed that India's digital financial infrastructure has the potential to transform emerging markets advance economies alike and that if other jurisdictions were to adopt a UPI-like payment solution, "*it would not be so much of a technical challenge to set up instant cross-border payments schemes*". The scale and penetration of the UPI framework in India is truly commendable and with the proposed Umbrella Entity framework in the play, one can be certain that the robust cashless payment industry in India will scale unprecedented heights.

Nevertheless, while light-touch regulations would have received a better reception from industry players, given that the Umbrella Entities would form an integral part of the financial infrastructure for retail payments in the country, the regulator's rationale for restricting foreign ownership and prescribing capitalisation requirements is understandable.

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